

COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

THE APPLICATION OF KENTUCKY-AMERICAN)	
WATER COMPANY FOR AN ADJUSTMENT)	CASE NO. 92-452
OF RATES)	

O R D E R

On December 22, 1993, the Commission granted Kentucky-American Water Company ("Kentucky-American") a rehearing on two issues discussed in our November 19, 1993 Order adjudicating Kentucky-American's rate application. Those issues, cost of long-term debt and medical cost trend rate adjustment to other post retirement employee benefits ("OPEB") expense, were addressed by Kentucky-American witnesses Edward J. Grubb, Assistant Director of Rates and Revenues, American Water Works Service Company, Inc. and James J. Marks, Principal, Towers Perrin. No intervenor testimony was filed and a hearing was held on March 17, 1994.

Cost of Long-Term Debt

Kentucky-American clarified that its rate application proposed the use of a 13-month average cost of long-term debt rather than the end of test period cost of debt utilized by the Commission for rate-making purposes. Due to conflicting exhibits filed by Kentucky-American, it appeared that Kentucky-American was proposing to use an 8.56 percent end of test period cost of debt rather than

the 8.63 percent 13-month average. Kentucky-American has demonstrated the reasonableness of its proposal to use the 13-month average forecasted period debt cost as better matching revenues and expenses. The Commission accepts Kentucky-American's clarification and supporting statements as reasonable and finds that its rates should be revised to reflect long-term debt cost of 8.63 percent.

Kentucky-American estimated that this change in the cost of long-term debt would result in an increase in its revenue requirement of \$14,545.¹ This calculation correctly showed interest expense increasing by \$37,381,² but incorrectly adjusted net operating income by \$22,636 due to including the debt cost as an operating expense in calculating the after tax effect of interest. Because the debt cost is not an operating expense, the correct adjustment to net operating income is \$14,745,³ the income tax effect of the debt cost. This results in an increase in Kentucky-American's revenue requirement of \$27,340.⁴

¹ Rehearing Testimony of Edward J. Grubb, page 4.

² Rehearing Testimony of Edward J. Grubb, Appendix A, page 14.

³ \$37,381 Interest x 39.445% Combined Income Tax Rate = \$14,745.

⁴

\$104,603,095 Rate Base x 0.03%* =	\$	31,381
Less: AFUDC		199
Interest Synch. - Income Tax	-	14,745
Operating Income Deficiency	\$	16,437
Times: Gross-up Factor	x	1.66328825
Increase in Revenue Requirement	\$	<u>27,340</u>

* Change in Rate of Return

OPEB Expense

In the November 19, 1993 Order, the Commission found Kentucky-American's medical cost trend rate to be excessive and, for rate-making purposes, reduced it by three percent. Since Kentucky-American had stated that a one percent reduction in this rate resulted in a 13 percent reduction in OPEB expense, the Commission used an arithmetic ratio to determine that a 3 percent reduction in the medical cost trend rate would result in a 39 percent reduction in OPEB expense. This 39 percent reduction in OPEB expense was reflected in the November 19, 1993 Order.

On rehearing, Kentucky-American demonstrated that its medical cost trend rate and OPEB expense do not vary in a linear relationship. Rather, a 3 percent reduction in the medical cost trend rate results in only a 31 percent reduction in OPEB expense. Reflecting a 31 percent reduction in OPEB expense, rather than a 39 percent reduction, results in an increase in revenue requirements of \$55,975.

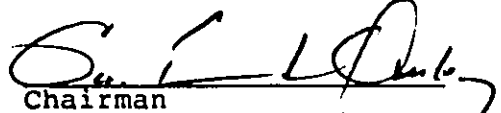
Conclusion

Based on the evidence on rehearing, the Commission finds that Kentucky-American has increased revenue requirements of \$83,315. The rates set forth in Appendix A attached hereto are designed to produce additional revenues of \$83,315 and are the fair, just, and reasonable rates to be charged by Kentucky-American for service rendered on and after the date of this Order.

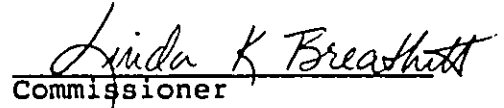
IT IS THEREFORE ORDERED that the rates set forth in Appendix A attached hereto be and they hereby are approved for service rendered on and after the date of this Order.

Done at Frankfort, Kentucky, this 4th day of May, 1994.

PUBLIC SERVICE COMMISSION


Chairman


Vice Chairman


Commissioner

ATTEST:


Executive Director

APPENDIX A

APPENDIX TO AN ORDER OF THE KENTUCKY PUBLIC SERVICE COMMISSION IN CASE NO. 92-452 DATED MAY 4, 1994

The following rates and charges are prescribed for the customers in the area served by Kentucky-American Water Company. All other rates and charges not specifically mentioned herein shall remain the same as those in effect under authority of this Commission prior to the effective date of this Order.

SERVICE CLASSIFICATION NO. 1

METER RATES

The following shall be the rates for consumption, in addition to the service charges provided for herein.

<u>Customer Category</u>	<u>Rate per 1,000 Gallons All Consumption</u>	<u>Rate Per 100 Cubic Feet - All Consumption</u>
Residential	\$1.86873	\$1.40155
Commercial	\$1.81009	\$1.35757
Industrial	\$1.51133	\$1.13350
Municipal and Other Public Authority	\$1.59178	\$1.19384
Sales for Resale	\$1.51293	\$1.13470

SERVICE CHARGES

All metered general water service customers shall pay a service charge based on the size of meter installed. The service charge will not entitle the customer to any water.

<u>Size of Meter</u>	<u>Service Charge</u>	
	<u>Per Month</u>	<u>Per Quarter</u>
5/8 Inch	\$ 5.58	\$ 16.74
3/4 Inch	8.36	25.08
1 Inch	13.92	41.76
1-1/2 Inch	27.83	83.49
2 Inch	44.52	133.56
3 Inch	83.47	250.41
4 Inch	139.13	417.39
6 Inch	278.26	834.78
8 Inch	445.23	1,335.69

SERVICE CLASSIFICATION NO. 3

AVAILABILITY OF SERVICE

Available for municipal or private fire connections used exclusively for fire protection purposes.

RATES

<u>Size of Service</u>	<u>Rate Per Month</u>	<u>Rate Per Annum</u>
2" Diameter	\$ 3.47	\$ 41.64
4" Diameter	13.87	166.44
6" Diameter	31.22	374.64
8" Diameter	55.49	665.88
10" Diameter	86.71	1,040.52
12" Diameter	124.88	1,498.56
14" Diameter	169.95	2,039.40
16" Diameter	221.99	2,663.88

SERVICE CLASSIFICATION NO. 4

RATES FOR PUBLIC FIRE SERVICE

	<u>Rate Per Month</u>	<u>Rate Per Annum</u>
For each public fire hydrant contracted for or ordered by urban county, county, state, or federal governmental agencies or institutions	\$21.73	\$260.76

RATES FOR PRIVATE FIRE SERVICE

For each private fire hydrant contracted for by industries or private institutions	\$31.22	\$374.64
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